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A2 GCE BUSINESS STUDIES

F297/01/CS Strategic Management

PRE-RELEASE CASE STUDY

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- This document consists of **8** pages. Any blank pages are indicated.

Lucy Cadel Trading Ltd (LCTL)

Lucy Cadel Trading Ltd (LCTL) trades under the brand 'Our Feathered Friends' (OFF). The company produces and supplies wild bird care products to the retail industry, principally garden centres, hardware stores and DIY outlets. In its last complete financial year (2010–2011) the company had sales revenues of slightly less than £5m, and it is on target to exceed this figure in the current year. If LCTL were to break the £5m sales barrier it would be a significant achievement in view of the recent recession and other external pressures. However, if the company was to continue to grow it might attract unwanted attention from predatory buyers, either existing businesses within the bird care market or others simply looking for an investment opportunity.

The potted history of the business is simple. Initially a Young Enterprise (YE) business with Lucy as Marketing Manager, it bought peanuts from a wholesaler and repacked them into 2 kg bags for sale at the twice weekly market in Oakford. Increasingly, Lucy found her fellow YE members less and less reliable and, hence, she found herself doing more and more of the work. As she did more, she began to really enjoy trading, and consequently her interest in academic study waned.

At the end of the school year, and despite some parental misgivings, Lucy decided that enterprise rather than academia was for her. Although the YE company had been wound up in May 1997, Lucy believed the name OFF had intangible value and, hence, she continued to trade under this identity. Free from the confines of school, and now with a second-hand van to her name, she expanded by attending markets in nearby towns six days per week. During this time she gradually added other wild bird feed products to OFF's range, so by 2000 she was selling 'straights' (single products such as peanuts, mealworms, sunflower seeds, etc.), 'mixes' (a recipe combining different ingredients), and fat based products. Most of her evenings were taken up working to add value by breaking bulk, routine administration, record keeping and planning the business' future. By 2001 further growth was being constrained by access to resources. Lucy recognised that, whilst she ran what her former business teacher would have described as 'a nice little cash rich business', further progress would require a significant change of scale. After considerable thought, Lucy 'took the plunge' and so incorporated the business as LCTL at the end of April 2002.

The share capital raised from friends and family allowed LCTL to rent a small industrial unit near the town centre, close to Oakford railway station. An investment was made in new automated packing machinery. Three staff were hired to work the packaging machines and perform tasks in the warehouse. Crucially, LCTL also paid for some professional consultancy. The consultant, Aliana van Hein, encouraged and helped Lucy to conduct a comprehensive strategic review of the business: a SWOT analysis, objective setting and culminating in a five year strategic plan.

Knowing from her own experience that barriers to entry into the wild bird care market are not substantial, Lucy hired a graphic artist to create a distinct visual identity for the OFF brand through point-of-sale merchandising displays and branded packaging. In line with the strategic plan LCTL ceased selling at markets and focused on supplying small independent retailers. Lucy worked tirelessly to build relationships with these customers. Typically, on a bag of peanuts, customers will add a 100% mark up on the £1.20 cost per kg bag when determining their retail price. With a recommended retail price printed on the packaging customers cannot easily increase prices, but by over-labelling a lower price can be used as a promotional tool. Travelling the length and breadth of the country Lucy would install point of sale displays on the understanding that if OFF products did not sell well enough, LCTL would buy back any surplus stock. Happily this rarely happened. She also sought to forge links with key players in the 'wild bird industry'. However, her approach to two leading wild bird charities was unsuccessful. The first rebuffed her approach due to its own commercial activity, whilst the second had an already well established link with the acknowledged market leader. On the other hand, joining the Birdcare Standards Association means the business is able to show on its packaging that its products are guaranteed to meet aflatoxin guidelines.

Some sources believe the 2012 retail value of the wild bird care market will be about £150m to £200m. Identifying the key external demand drivers is not easy, and deciding which is the most important is doubly difficult. Lucy knows that macroeconomic factors play a part, but lifestyle choices and social changes also contribute. Lucy is convinced that the whole wild bird care industry has benefited from increased media coverage of UK natural history such as the BBC's Spring Watch. On a more immediate level, weather is a major influence. Indeed, just by looking at weekly orders it is possible to track cold snaps as retailers experience an upsurge in sales. During particularly cold periods, consumers buy more feed to put out for the birds, and, the birds themselves eat more. However, particularly severe weather can hamper consumers' ability to get to the retailers and hence, sales might actually fall. LCTL aims to meet customer orders within 72 hours, with goods being despatched by its contracted logistics company.

In 2007 a second five year review sought to identify further growth opportunities. Winning new customers was becoming increasingly difficult. Consequently, growth through related diversification was chosen as the best way forward: hence LCTL added non-food bird care products such as feeders and bird boxes to its product portfolio. These products, like the majority of all of LCTL's stock are imported, with the majority of feed and non-food items coming from China. The objective was to have non-food products contributing 25% of sales by 2012. By 2007 staff numbers had grown to five, one of whom was an Administrator. A year later, in 2008, LCTL invested capital in a 'view only' website. Regular updating of the website is accounted for as a marketing expense. The site has two functions. First, to publicise the OFF brand and so, in turn, support retail customers. Second, to educate and inform consumers about wild birds and their care. Whilst initially hesitant, once the retailers saw the quality and purpose of the website they were very enthusiastic about it and remain so.

To assist in setting the strategic direction for the next five years (2012–2016) Lucy has drafted a SWOT analysis for LCTL (see Fig. 1).

Fig. 1 – SWOT Analysis for LCTL

Strengths	Weaknesses
Respected national brand Motivated and flexible staff Supportive shareholders Gearing, access to external funding Liquidity Informative website Efficient logistics partner	Packaging and warehouse site capacity – currently operating at 92% Management; wholly reliant on Lucy, who in turn relies on external expertise
Opportunities	**Threats**
Export sales unexploited Enquiries from national retail chains Media coverage encouraging wild bird care UK population affluence Diversification into other 'birding' lifestyle products (binoculars, clothing, etc) Growth in both Royal Society for the Protection of Birds (RSPB) and British Trust for Ornithology (BTO) membership On-line sales – direct to households	Competitors; size and scope Exchange rate movements Customer consolidation; the decline in independent garden centres Consumers buying via the Internet Decreasing margins Takeover

Lucy is again keen to set ambitious objectives for her company, and feels that although the national market is maturing, an average annual revenue growth of 8% for the next five years is achievable. Table 1 shows a rolling, four quarter, budgeted profit and loss account, together with the actual data for the three most recent quarters.

Table 1 – Budgeted and Actual Profit and Loss Accounts (Income Statements) LCTL 2011–2012

	February 2011–April 2011 Q2		May 2011–July 2011 Q3		August 2011–October 2011 Q4		November 2011–January 2012 Q1	
	Budget £000s	Actual £000s	Budget £000s	Actual £000s	Budget £000s	Actual £000s	Budget £000s	Actual £000s
Revenue								
Feed	940.0	958.0	940.0	924.0	970.0	1,018.0	1,000.0	n/a
Non-feed	320.0	346.0	320.0	318.0	320.0	358.0	300.0	
	1,260.0	1,304.0	1,260.0	1,242.0	1,290.0	1,376.0	1,300.0	
Costs of sales								
Feed	564.0	565.2	564.0	554.4	582.0	621.0	600.0	
Non-feed	160.0	176.5	160.0	162.2	160.0	186.2	150.0	
Direct labour	45.0	46.0	45.0	46.5	45.0	46.0	48.0	
	769.0	787.7	769.0	763.1	787.0	853.2	798.0	
Gross profit	491.0	516.3	491.0	478.9	503.0	522.8	502.0	
Administration, Marketing & other expenses	113.4	116.1	113.4	114.3	116.1	126.6	117.0	
Premises	15.0	15.0	15.0	15.0	15.0	15.0	15.0	
Distribution	176.4	195.6	176.4	173.9	180.6	192.6	182.0	
Salaries	70.0	70.0	70.0	70.0	70.0	70.0	72.0	
Operating profit	116.2	119.6	116.2	105.7	121.3	118.6	116.0	
Interest expense	4.0	4.5	4.0	4.3	4.0	4.3	4.0	
Net profit	112.2	115.1	112.2	101.4	117.3	114.3	112.0	

Although LCTL produces budgeted and actual profit and loss figures for each quarter, it only produces an actual balance sheet as at the end of each financial year (i.e. as at 31 October). It is company policy, however, that ratios are calculated on an annual basis (covering the four most recent quarters) at the end of each quarter and are based, where appropriate, on the most recent year end balance sheet.

Lucy would also like to see improved profitability, and she has set targets for 2017 of:

- gross profit margin, 45%
- net profit margin, 12.5%
- return on capital employed, 42%
- return on equity, 55%.

Lucy has been encouraged by Aliana not simply to focus on profitability. Aliana has offered Lucy some industry comparative data (see Table 2).

Table 2 Comparative ratio data

	LCTL 2010	Industry average data 2010
Profitability		
Return on capital	38.5%	41.9%
Net profit margin	8.1%	12.1%
Gross profit margin	36.7%	41.3%
Return on equity	47.9%	55.6%
Liquidity		
Current ratio	1.21	1.30
Acid test	0.59	0.67
Activity		
Days stock	114.7	102.7
Days debtors	104.9	57.9
Days creditors	184.5	154.6

It is against this background that Lucy is wondering what to do about three issues.

The first is an approach from a discount supermarket chain, Price Pulveriser, (PP). It wants LCTL to supply 1 kg packs of peanuts in PP branded packaging. The initial order is for 200,000 kg to be delivered to PP by July 2012 so these products will be in its stores for the autumn. Thereafter, there would be a renewable quarterly supply of 50,000 kg, with a 90 day payment period, at an ex-LCTL unit price of £1 per kg. Taking the order would provide the catalyst to relocate from the currently cramped 280 m^2 premises and to up-grade some of the company's equipment. However, Lucy is aware that this order would represent a movement away from LCTL's established customer base.

The second issue is whether to relocate the business. The current site can pack, for example, approximately 800,000 kg of peanuts per year and, as it is already producing about 783,000 kg, a move seems inevitable, and entirely independent of the PP decision. Steve Preedy, a commercial estate agent with over five years local experience, has recommended to Lucy two sites both in excess of 500 m^2. One site is in Oakford and is available for a 5 year lease and at a rent of £51.50 m^2. The other is about five miles away at £40.00 m^2 and is available for a three year lease. Lucy estimates that in both cases a further £70,000 per year would need to be budgeted for adding to the current 12 production and warehouse staff. There are clear advantages to this organic growth. However, the decision is complicated by the significant step in fixed costs, which creates its own additional risk. There are also several non-quantifiable factors which also need to be considered. Another consideration is what LCTL's shareholders might want. Lucy is the majority shareholder, and to date her other shareholders have tended to be passive in their support. Possibly this is because they are happy with a dividend policy which distributes 50% of net profits to them. However, Lucy realises that she cannot take their continued support for granted.

The third issue is rather more puzzling and concerns an article from the local paper, the Oakford Oracle (see Fig. 2).

Fig. 2 – Article from the Oakford Oracle

All creatures great and small, by Jenny Roman, Oakford Oracle

A visiting preacher, the Reverend Paul Hodson, caused something of a storm when he preached at Oakford All Saints, last Sunday. His message was simple but challenging. In the Western World we consume too many of the earth's precious resources and in doing so condemn much of the planet to a subsistence existence of less than US$1 per day. He claimed in his sermon that the average family pet in the UK is better cared for than most people in the developing world. Speaking to this reporter later in the week he said:

"Did you know, that keeping a cat costs about £700 per year? And a horse would easily eat its way through £2,000 a year. Yet in sub-Saharan Africa people are literally starving to death. Some in Africa toil under inhumane conditions to grow peanuts which we then feed to the birds! We in the West should hang our heads in shame. It is a moral crime that we spend so much on animals when our own species is barely clinging to life in some parts of the world."

He went on to say that local bird feed company Our Feathered Friends epitomised the problem and called the business "….morally bankrupt. I challenge them to give 50% of their profits to charities. As an absolute minimum they should only buy from fairtrade suppliers".

Lucy Cadel, Managing Director of the £5m business, was unavailable for comment when we went to press.

The journalist, Jenny Roman, has asked for a comment but Lucy is really not sure how, if at all, she should respond. However, she could see some irony here as the same paper had, just a month previously, published another story about LCTL. The East Midlands Business Forum had voted Lucy 'East Midlands Regional Entrepreneur of the Year 2011 in the under 35 age category'. Whilst such an accolade was a morale boost for Lucy she is determined to share her success with the workforce, and so has organised a forthcoming celebratory team day out: go-karting followed by dinner at Belvoir Park, a nearby premium hotel and restaurant. The award also comes with 10 days of free business advice and consultancy services for the coming 12 months. That advice might be needed given the news which Aliana had shared with her at the award ceremony. It seems the industry leader has been making not very discreet enquiries amongst LCTL's suppliers, some of whom now expect a takeover to be in the offing.

Appendix 1 – Extracts from LCTL's Balance Sheet as at 31 October 2011

Lucy Cadel Trading Limited		
	£000s	£000s
Fixed assets		
Equipment, net of depreciation		320
Current assets		
Stock	1,598	
Debtors	1,476	
Cash	305	
	3,379	
Current liabilities		
Trade creditors	2,257	
Dividend payable	230	
	2,487	
Net Current assets		892
Creditors falling due after more than one year		200
Net assets		1,012
Share Capital		80
Profit and loss account		932
Equity shareholders' funds		1,012